

DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 04-0015
GROSS RETAIL TAX
For 2002 and 2003

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I. Aircraft Lease Payments – Gross Retail Tax.

Authority: IC 6-2.5-4-10(a); IC 6-2.5-4-10(b); IC 6-2.5-2-1; IC 6-2.5-5-1 to 70; IC 6-2.5-5-8; 45 IAC 2.2-4-27(a); 45 IAC 2.2-4-27(c); 45 IAC 2.2-4-27(d); 45 IAC 2.2-4-27(d)(1); Blacks Law Dictionary (7th ed. 1999).

Taxpayer argues that the Department of Revenue (Department) erred when it calculated the amount of gross retail (sales) tax taxpayer purportedly should have been collecting from pilot/lessee.

STATEMENT OF FACTS

In August of 2002, taxpayer entered into an "Aircraft Hourly Rental Agreement" with pilot/lessee. Pilot/lessee agreed to pay an "hourly rent" of \$1,275. In addition, pilot/lessee agreed to assume the costs of maintaining, repairing, hangering, and insuring the aircraft. Pilot/lessee also agreed to pay for fuel, crew expenses, landing fees, and taxes. Thereafter, the amount of "hourly rent" would be offset by the amount pilot/lessee spent for these specific aircraft-related expenses.

In September 2002, taxpayer submitted an "Application for Aircraft Registration or Exemption." On that form, taxpayer indicated that the initial purchase price of the aircraft – approximately three million dollars – was not subject to sales tax because the aircraft was purchased for "Rental or Lease to others per IC 1971-6-2.5-5-8."

In June of 2003, the Department sent a letter to taxpayer indicating that the Department was conducting a review to determine if the taxpayer's aircraft "is being predominately used in the exempt manner claimed." In that letter, the Department requested that taxpayer provide certain documentation substantiating the proposition that the aircraft was purchased for an exempt purpose and that the aircraft was thereafter used for that purpose.

Later that same month, taxpayer responded by providing the requested information.

The Department reviewed the submitted information, and – in a letter dated August 2003 – issued its decision finding that “sales/use tax due was computed incorrectly.” The Department concluded that taxpayer should have been collecting sales tax on the \$1,275 base amount listed in the parties’ “Aircraft Hourly Rental Agreement.” However, the Department stated that taxpayer was not entitled to “a deduction for expenses incurred in operating and maintaining the aircraft from the gross rental amount.” In other words, the Department found that the provision in the parties’ agreement permitting pilot/lessee to deduct from the base hourly rate the amount pilot/lessee spent on maintaining, repairing, and operating the aircraft was a nullity for purposes of determining sales tax liability. Thereafter, the Department issued notices of “Proposed Assessment” imposing sales tax calculated on the base hourly rate of \$1,275.

In October of 2003, the taxpayer protested the assessment of additional sales tax arguing that taxpayer was only required to collect sales tax based upon the formula contained in the parties’ lease agreement. Taxpayer maintains that amount charged to the pilot/lessee – the base-hourly rate less the amount of the pilot/lessee’s aircraft expenses – was “the fair market value of the underlying equipment of a comparable charter.”

An administrative hearing was conducted during which taxpayer’s representative explained the basis for the protest. This Letter of Findings results.

DISCUSSION

I. Aircraft Lease Payments – Gross Retail Tax.

Taxpayer maintains that the Department erred when it decided that taxpayer should have been collecting sales tax on the base-hourly rate provided for in the lease agreement between taxpayer and pilot/lessee.

Indiana imposes a gross retail (sales) tax on retail transactions in Indiana. IC 6-2.5-2-1. The state legislature has provided a number of exemptions to the imposition of that tax. *See* IC 6-2.5-5-1 to 70. One of those exemptions is found at IC 6-2.5-5-8 which states that, “Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property.”

Therefore, if taxpayer bought the aircraft for the purpose of leasing it to others, taxpayer was not required to pay sales tax on the purchase price because taxpayer bought the plane for “an exempt purpose.”

However, once a person – such as taxpayer – gets into the business of leasing tangible personal property, that person is required to collect sales tax on the lease payments. IC 6-2.5-4-10(a) states that, “A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person.”

The Department’s regulation defines what it is that a person in the leasing business should be collecting sales tax on. 45 IAC 2.2-4-27(a) states that, “In general, the gross receipts from

renting or leasing tangible personal property are taxable. This regulation [] only exempts from tax those transactions which would have been exempt in an equivalent sales transaction.”

The regulation defines “gross receipts” obtained from leasing tangible personal property. “The rental or leasing of tangible personal property, by whatever means effected and irrespective of any terms employed by the parties to such transaction is taxable.” 45 IAC 2.2-4-27(d).

If the above language is in any way ambiguous, the regulation further explains that, “The amount of actual receipts means the gross receipts from the leasing of tangible personal property without any deduction whatever for expenses of costs incidental to the conduct of the business. The gross receipts include *any consideration* received from the exercise of an option contained in the rental [or] lease agreement” 45 IAC 2.2-4-27(d)(1) (*Emphasis added*).

Taxpayer has a lease agreement with pilot/lessee which requires that pilot/lessee pay \$1,275 for each hour that pilot/lessee uses the taxpayer’s aircraft. If pilot/lessee uses taxpayer’s aircraft for 10 hours, pilot/lessee owes taxpayer \$12,750. However, the parties’ agreement also provides that if pilot/lessee incurs expenses associated with maintaining and operating the aircraft, the pilot/lessee must pay those expenses but is thereafter entitled to deduct the amount of expenses from the base lease amount. Therefore, if pilot/lessee incurs \$10,000 in aircraft-related expenses, pilot/lessee can deduct \$10,000 from the example cited above. Instead of paying \$12,750, pilot/lessee will pay \$2,750; taxpayer will collect that amount along with the sales tax due on the lesser amount. If pilot/lessee should incur aircraft expenses equal to the amount of the base lease amount due during a particular period, pilot/lessee will owe \$0 and taxpayer will collect \$0 in sales tax.

When a lessor rents tangible personal property, it must collect sales tax on the “gross receipts” received. 45 IAC 2.2-4-27(c). The amount of the tax liability is never affected by the terms of the parties’ lease agreement. As stated in the regulation, “The rental or leasing of tangible personal property, by *whatever means effected and irrespective of the terms employed* by the parties to describe such transaction, is taxable.” 45 IAC 2.2-4-27(d) (*Emphasis added*). The term “gross receipts” means, “The total amount of money or other consideration received by a business taxpayer for goods sold or services performed in a year, before deductions.” Black’s Law Dictionary 710 (7th ed. 1999). The gross receipts means the amount of consideration received by the lessor “without any deduction whatever for expenses or costs incidental to the conduct of the business.” 45 IAC 2.2-4-27(d)(1).

Taxpayer contends that it should collect sales tax based upon the hourly rate of \$1,275 reduced by the amount of expenses the pilot/lessee incurred during a particular lease period. Under taxpayer’s interpretation of the sales tax statute, taxpayer will collect sales tax on an amount somewhere between \$1,275 and \$0 depending on the extent of pilot/lessee’s associated expenses.

Setting aside the issue of whether the parties’ “Aircraft Hourly Rental Agreement” is actually a “lease” between two disinterested parties, taxpayer’s argument fails because – in allowing a deduction for pilot/lessee’s expenses – taxpayer is ignoring a substantial portion of the consideration it receives by virtue of that agreement. Pilot/lessee is paying to maintain and repair *taxpayer’s* aircraft. Pilot/lessee is paying to insure *taxpayer’s* aircraft. Pilot/lessee is paying to

provide hanger space for *taxpayer's* aircraft. Pilot/lessee is paying the costs associated with taxpayer's ownership of *taxpayer's* aircraft and the operation of *taxpayer's* leasing business. All of these expenses are a portion of the consideration taxpayer receives from pilot/lessee, and taxpayer is ignoring the fact that it is required to collect sales tax on "any consideration" obtained as a result of the lease agreement between itself and pilot/lessee. "Consideration" is defined as "[s]omething of value (such as an act, a forbearance, or a return promise) received by a promisor from a promisee." Black's Law Dictionary 300 (7th ed. 1999). In the parties' lease agreement, taxpayer is receiving additional consideration from pilot/lessee beyond the adjusted \$1,275 base hourly amount. Pilot/lessee is promising to pay for the entire cost of insuring, maintaining, and operating an aircraft which pilot/lessee does not own. Taxpayer owns this aircraft; therefore, the fact that the pilot/lessee pays for all the variable expenses attendant upon the operation of ownership and operation of the aircraft is a substantial benefit which flows in taxpayer's direction. The cost of the variable expenses is one portion for the consideration which taxpayer receives in exchange for which taxpayer grants pilot/lessee the right to use taxpayer's aircraft. Therefore, taxpayer should have been collecting sales tax on the total amount of consideration it received from pilot/lessee which would have included the adjusted base hourly rate together with the amount of money pilot/lessee spent on taxpayer's behalf in maintaining and operating the aircraft.

FINDING

Taxpayer's protest is respectfully denied.

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